No. 3110

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

I. F. SEARLE, MINNIE A. GIBBS and MERRILL, COX & COMPANY, Creditors of the Estate of Stack-Gibbs Lumber Company, Bankrupt,

Appellants,

vs.

MECHANICS LOAN & TRUST COMPANY and THE EXCHANGE NATIONAL BANK OF SPOKANE, Creditors of Stack-Gibbs Lumber Company, Bankrupt,

Appellees.

IN THE MATTER OF STACK-GIBBS LUMBER COMPANY, Bankrupt.

Upon Appeal from the United States District Court for the District of Idaho, Northern Division.

APPELLANTS' REPLY BRIEF.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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(Numbers refer to pages of printed record.)

We desire to reply to appellees answer brief:

In the first instance, we desire to correct certain statements made in their "statement of facts".

Counsel states that Mr. Gibbs submitted to the creditors at Minneapolis a statement of assets and liabilities and that the creditors figured that when the trust deed was signed by Mrs. Tolerton that that would constitute 90% of the debts of the company. The record shows that this testimony was given in a voluntary manner by Mr. Coman but immediately following it appears the following:

> "Mr. ADAMS. I move to strike that out as a voluntary statement without any question. The REFEREE. It may be stricken." (Rec. 220.)

The record is silent so far as the writer knows, of any attempt on the part of the appellee to renew this testimony.

Again counsel without the semblance of a record to bear out his assertion, states that the witness, Katz, was an adverse witness "friendly to his Chicago friends" etc. Mr. Katz's testimony was frank in every respect nor is there any ground for the assertion that he was in any manner or form adverse to the appellees.

We also take exception to the statement of counsel that it was understood that the trust company would get $100,000 to be advanced to the bankrupt from the Exchange National Bank and that this was talked over and understood at the Minneapolis meeting.

The record with reference to this subject is that Mr. Coman, the president of the Exchange National Bank and at least the guiding hand and spirit of

the Mechanics Loan & Trust Company, testified that he had a conversation with the vice-president of the Fort Dearborn National Bank who wanted to know the responsibility of the trustee and that Mr. Coman told him that while the capital of the trust company was only $10,000 that it could get the money from the Exchange National Bank. While Mr. Coman testified as an interested party in every respect, still he admitted that these various discussions were all had prior to either the drawing up of the contract or at least before it was signed (217) so that whatever arrangement was had with reference to who should advance the money, merged into the written agreement which is surely sufficiently plain to speak for itself without the aid of oral testimony in explanation thereof.

Counsel further states that the Exchange National Bank had not kept in touch with the bankrupt. Mr. Coman testified that he was the banker and connected with Mr. Gibbs, the managing officer of the bankrupt. He stated (216) that he went to Minneapolis with Mr. Gibbs; That his bank (Exchange National) was the owner of the bonds of the Dryad Lumber Company, the subsidiary corporation of the bankrupt, amounting to $100,000.00; That before the meeting was called by Mr. Coman and even before he went East, Mr. Coman caused his attorney, Mr. Post, to in fact prepare a trust deed along the lines of the trust that was afterwards consummated (216). In addition to this, it affirmatively appears (246) that be-

fore the meeting was called at Minneapolis by Mr. Coman, that Mr. Coman discussed the whole proposition with Mr. Gibbs and even sent a representative to Coeur d'Alene to inspect the affairs of the bankrupt (246). This is based not upon the testimony of the so-called "adverse witness" but upon the admission made in open court by Mr. Coman and every inference points to the fact that Mr. Coman did in fact know the true condition of the bankrupt before he went to Minneapolis. Mr. Coman is an astute, clever banker and we cannot understand the denial of counsel that he, being in touch with Gibbs, calling the creditors together at the instance of Gibbs, causing a trust deed to be prepared which would not only protect his bank but would pay part of its indebtedness unknown to the other creditors and would further the operation of the plant of a client of the bank of which he was the head, going into this thing blindly and accepting the unsupported word and representation of a man, where there was involved practically three quarters of a million dollars in debts and where his own bank intended as he now claims, to further advance the sum of $100,000. In addition to this, counsel stated that Merrill, Cox & Company had prior to this time, sent an accountant to go over the affairs of the bankrupt. So far as the record shows, there is no testimony to support any such assertion. We insist, however, that the entire record bears out the assertion that Mr. Coman did in fact know more

about the precarious financial condition than any one else, except HIS friend, Gibbs.

Argument.

Taking up the argument of counsel, we desire to first notice the eleventh assignment wherein the appellee states that there is no support to the theory of the appellants, that the signing creditors are not bound by the trust because of false and fraudulent representations of Mr. Coman and further states that there is no evidence to bear this out. We insist that the whole record is a mass of testimony which does bear this out. It is shown that Mr. Gibbs did submit a statement to the creditors at the meeting at Minneapolis; That he was accompanied and brought to the meeting by Mr. Coman who either by his silence or express representations and it is immaterial which, did not dissent but acquiesced in it. The condition that is afterwards shown by the statement made up by Mr. Katz shows the concern to have been hopelessly and helplessly insolvent at that time. If we speak of good faith, then the representative local banker of the bankrupt who calls together a meeting of creditors; who impliedly infers that his assertions are true; who inveigles creditors holding claims aggregating more than three quarters of a million dollars, to repose in him and his associates sufficient trust and confidence that in a manner they pledge their claims

to the payment of a further extension of credit of $100,000—then if this sort of testimony has no bearing on the good or bad faith of a trustee, the writer is at loss to understand the rules of equity and the law with relation to the good or bad faith of trustees.

With reference to this question of good or bad faith, counsel says that no express reservation was made in the record to show that we are claiming bad faith. The entire record shows that the appeal is practically based upon the unconscionable, faithless acts of the appelles. Page after page of the record was consumed to show that the Exchange National Bank secured $15,000 out of the trust funds that the trust company was supposed to advance, page after page was consumed to show that a secret record was made of this transaction. Records were introduced by Mr. Post to show that notwithstanding the fact that the bank claimed that the $15,000 was never in fact loaned but that the notes were returned long prior to the meeting at Minneapolis, yet in fact they were not returned nor even marked cancelled until after the signing of the trust deed, and then it was further expressly shown that long after the signing of the trust deed the bank received interest upon the indebtedness created by these notes paid out of this "trust fund" and accepted the same and credited the same upon the books of the bank. The great bulk of the recorded testimony is then to the effect that the bank had acted in bad faith and dishonestly and we can easily

understand why counsel would want to put aside this question on the technical grounds that the express reservation is not made in the petition for review of bad faith in so many words. The petition for review recites many grounds of error where this could be introduced, was introduced and argued and was entertained and considered by the District Judge both in the oral argument and in the written brief submitted.

JURISDICTION.

We direct attention to the square and emphatic admission made by them that they stand or fall upon the two propositions; one, that they have a lien on all of the property of the bankrupt and second, an equitable assignment of the claims of the signing creditors. (Appellees' Brief, p. 17.)

The jurisdiction of the federal courts to afford the appellees adequate relief if they are entitled to any, is so clearly within the knowledge of your Honors that we do not deem it necessary to answer that part of the answer brief wherein it is stated that in the event that Judge Dietrich's decision is overturned, the appellees would not have an adequate remedy.

Nor do the decisions cited by counsel in any way modify or change the general rule that the referee was without jurisdiction to make the order that was appealed from, and we will briefly notice some of the decisions that are cited by counsel.

Counsel states that the question of jurisdiction is settled beyond controversy by the Supreme Court of the United States in *Whitney v. Wenman,* 198 U. S. 539; 45 L. ed. 1157. This action was an action by the trustee against a third party holding property belonging to the estate and by either fact or inference could not be pertinent to the case at bar. The matter decided is so clearly stated in the syllabus that we content ourselves by quoting therefrom in its entirety to show that the court had in mind no such state of facts as is presented by this appeal.

> "Jurisdiction of a proceeding in the nature of a plenary action, in which the parties were duly served and brought into court, to determine rights in or liens upon property which, under the facts as admitted by demurrer to the bill, came into possession of a court of bankruptcy as property of the bankrupt, whether held by him or for him, was conferred on such court by the bankrupt act of July 1, 1898, paragraph 2 (30 Stat. at L. 545, Chap. 541, U. S. Comp. Stat. 1901, p. 3420), authorizing the bankruptcy court to cause the estate of the bankrupt to be collected, reduced to money, and distributed, and to determine controversies in relation thereto, and bring in and substitute additional parties when necessary for the complete determination of a matter in controversy; and such jurisdiction is not ousted by an unauthorized surrender of the property by the receiver in bankruptcy."

The same thing is true of the case of *In re Antiago Screen Door Company,* 123 Fed. 249, which was merely litigation between the trustee and a

mortgagee as to the legality of a mortgage given by the bankrupt prior to bankruptcy. Herein the bank had filed a petition praying that it might have the fund realized to the amount of the mortgage and where the court held that the mortgages were void. From this order, an appeal was taken and the court in the opinion (253) says:

> "We are disposed to hold (although the case is one not free from difficulty) that the order is one made in the bankruptcy proceedings proper. The general rule of practice of the courts is not without weight, although the particular question is not suggested in most of the cases which recognize the practice. The mortgaged property was in equity, the property of the bankrupt, subject to such lien as the mortgagee had thereon. *If its value was in excess of a valid lien, that excess would go to the trustee.*"

How anything that was said in either of the two last cases which counsel insists is decisive of the case at bar, could guide or govern a court in determining this controversy is beyond comprehension.

Likewise, the case of *In re Paris Modes Co.,* 196 Fed. 357. Here was a case where one Gaines was the treasurer of a publishing company and made a mercantile statement wherein he claimed that the publishing company owed nothing. On this statement a printer advanced credit to the bankrupt and after the bankrupt had been adjudicated insolvent, Gaines filed a claim for many thousands of dollars against the estate. In the proceedings in the District Court it was ordered that the order allowing the claim of

Gaines be modified to the extent that so much of the allowance representing indebtedness of the bankrupt prior to the time of the making of the false statement should be postponed to the claim of the printer and this order was never appealed from; this order seems to have been entered by agreement. Judge Lacombe, the Circuit Judge, who reviewed this case in the Second Circuit in connection with Judges Ward and Noyes [regardless of the fact that no error predicated or appeal taken], questions the right of the referee or the District Judge to make any such order (p. 358, 196 Fed.):

> "The difficulty with the plan followed by the District Court is, first, that it does not accord with the order of June 22; and second, it takes money awarded to Gaines as a dividend on his claim of $199,000, and turns it over to the Wynkoop Company, as damages for a tort, *which we think the bankruptcy court has not jurisdiction to do. The company can take that cause of action to a state court and try it there. This we understand it had done.*
>
> *The order is reversed and cause remanded, with instructions to distribute the balance of dividends $12,250 or whatever it may be in accordance with the views expressed in this opinion.*"

Notwithstanding that all the parties attempted to confer jurisdiction, the Circuit Court of Appeals refused to permit the distribution of the funds in the manner thus ordered and stated that it was a matter for a plenary action in a court of competent jurisdiction. While counsel states that the distribution of these funds was enforced by a court of bank-

ruptcy according to the agreement between the parties in that case, yet the court refused to entertain jurisdiction of a controversy between the parties as to the right to the dividends and referred them to their rights in a plenary action at law, nor can we comprehend how counsel comes to cite this case (Appellees' Brief, p. 20) as antagonistic to the appellants' theory of want of jurisdiction on the part of the referee to make the order complained of.

The proposition that is advanced by counsel that in order to avoid the rule against multiplicity of suits that not only must the remedy be efficient but that it must be a remedy in the same jurisdiction, is supported by no law nor is it the rule. If a full complete and adequate remedy at law exists, no matter in what jurisdiction it lies, then equity refuses to interfere and this is true notwithstanding the general rule of convenience in this class of cases, because it is almost invariably combined with other circumstances of inadequacy and is too indefinite to safely afford an independent ground for the interposition of equity. (*16 Cyc.* 42.)

When these parties met in Minneapolis and there entered into this contract, each of the parties knew of the residence of the other. The Mechanics Loan & Trust Company, for instance, knew that the legal residence of Merrill, Cox & Company was in Chicago, nor can it now be heard to say that because a fund happens to be near the particular jurisdiction of the appellees that on that ground should equity interpose its helping hand and take juris-

diction over all the parties who find themselves in the unfortunate position of signers to the trust deed.

The criticism that is directed to the *Henry* case, 145 Fed. 316, is equally without merit. As has been stated in the original brief filed herein in that case, the conflicting claims of two claimants was not permitted to be litigated in the bankruptcy proceeding because the entire estate was not interested in the controversy nor could it by any circumstances enure to the benefit of the general estate. The court in its opinion, however, stated that neither of the claimants were parties to the bankruptcy proceedings which we consider immaterial, but in the opinion of the writer the appellants in this action are no more parties to the bankruptcy proceeding in the sense that the word "parties" is usually used than is a creditor who in order to secure his claim advises a court by appropriate petition that a debtor has died and thus starts the wheels turning which ultimately causes the estate to be administered. These appellants nor the appellees are in no sense litigants in the bankruptcy proceedings. They may have by their petition caused the bankruptcy proceedings to have been instituted and they may have filed their claims against the estate, but this does not make them parties to the litigation. Appeals could be taken, orders could be made, a discharge refused or allowed and a multitude of other proceedings taken without notice to them, without their consent and without their sanction.

In a late case by the Supreme Court of Arkansas, the right of bankruptcy courts to consider these indefinite actions is discussed and the authorities are reviewed:

> "It is also true that referees in bankruptcy 'take the same oath of office as judges of the United States courts,' are referred to 'as an arm of the bankruptcy court, invested with certain judicial powers,' and as 'a court of very great importance in the administration of bankrupt assets and the determination of conflicting rights arising thereunder,' and in their hearings within the scope of their powers are clothed with the authority of judges. White v. Schloerb, 178 U. S. 542, 20 Sup. Ct. 1007, 44 L. ed. 1183; Loveland on Bankruptcy, 205; Gilbertson v. United States, 168 Fed. 672, 94 C. C. A. 158; in re Simon & Sternberg (D. C.) 142 Fed. 593. 'Judge,' however, as defined in the act, means a judge of a court of bankruptcy, not including the referee. See Bankruptcy Act.
>
> Proceedings by creditors to prove their demands against the estate of a bankrupt are part of the suit in bankruptcy, *and are not separate or independent suits in law or in equity;* the Bankruptcy Act being passed to provide a quick and summary settlement of debts against the bankrupt out of the proceeds of his estate, and proceedings originally commenced as part of the bankruptcy suit are not separated from it and converted into a suit at law. Wiswall v. Campbell, 93 U. S. 347, 23 L. ed. 923; Leggett v. Allen, 110 U. S. 741, 4 Sup. Ct. 195, 28 L. ed. 313.
>
> *It is settled that bankruptcy courts under the present Bankruptcy Act have no jurisdiction of independent suits at law or in equity.* Bardes v. Bank, 178 U. S. 535, 20 Sup. Ct. 1005, 44 L. ed. 1175. It was there said:

'Proceedings in bankruptcy generally are in the nature of proceedings in equity; and the words "at law" in the opening sentence, conferring on the courts of bankruptcy "such jurisdiction, at law and in equity, as will enable them to exercise original jurisdiction in bankruptcy proceedings," may have been inserted to meet clause 4, authorizing the trial and punishment of offenses, the jurisdiction over which must necessarily be at law, and not in equity. The section nowhere mentions civil actions at law or plenary suits in equity. And no intention to vest the courts of bankruptcy with jurisdiction to entertain such actions and suits can reasonably be inferred from the grant of the incidental powers, in clause 6, to being in and substitute additional parties, "in proceedings in bankruptcy," and in clause 15, to make orders, issue process, and enter judgments, "necessary for the enforcement of the provisions of this act." '

In Bush v. Elliott, 202 U. S. 479, 26 Sup. Ct. 670, 50 L. ed. 114, the court said:

'The Bankruptcy Act of 1898, in respect to matters now under consideration, was a radical departure from the act of 1867, in the evident purpose of Congress to limit the jurisdiction of the United States courts in respect to controversies which did not come simply within the jurisdiction of the federal courts as bankruptcy courts, and to preserve, to a greater extent than the former act, the jurisdiction of the state courts over actions which were not distinctly matters and proceedings in bankruptcy.'

As said in the Bardes case:

'Congress, by the second clause of section 23 of the present Bankrupt Act, appears to this court to have clearly manifested its intention that controversies, not strictly or properly part of the proceedings in bankruptcy, but independent suits brought by the trustee in bankruptcy

to assert a title to money or property as assets of the bankrupt against strangers to those proceedings, should not come within the jurisdiction of the District Courts of the United States, "unless by consent of the proposed defendant," of which there is no pretense in this case.'

See also, Bank v. T. & T. Co., 198 U. S. 291, 25 Sup. Ct. 693, 49 L. ed. 1051.

It is evident from these authorities that there was no intention upon the part of the lawmakers to give the bankruptcy courts jurisdiction to render personal judgments against bankrupt debtors as in civil suits at law or in equity, and there was no such judgment attempted to be rendered in said court. The allowance by the referee of the claim was within the jurisdiction of the referee in the bankruptcy proceeding, and binding and conclusive against the bankrupt's estate, unless reversed upon appeal."

Maryman v. Dryfus Co., 174 S. W. 549-550-551.

The writer, who was not the author of the original brief in this case, desires to call attention to that part of the appellees' brief wherein we are accused of criticising Judge Dietrich. Not only the writer but each of counsel for the appellants have the highest regard and highest respect for the learning, ability and integrity of the Judge from whose decision this appeal is taken. In the present case, we have disagreed with him, but we have not criticised him nor is an assertion of this kind in keeping with proper ethics in any litigation. Neither is our assertion of what we deem a mistake on the part of the District Judge made with any meaning of criticism or disrespect, but what is stated in appellees' brief

which we consider not only wholly incomprehensible but not in keeping with this discussion. We sincerely trust that by mistake it has crept into their answer brief and it is not intended as it appears, to be cheap politics.

REAL PARTY IN INTEREST AND RIGHTS OF BANK AND TRUST COMPANY.

As counsel for appellee has disposed of the good or bad faith of the appellees by ignoring the argument of the appellants so again does it desire to waive aside any discussion on the subject of subrogation. They say in the brief "as we deem that the principle of subrogation is not involved in this matter but quite a different principle which we have discussed below, we have not read the authorities cited and make no reference thereto." (Appellees' brief, p. 30.)

Yet by no other principle of law can the Exchange National Bank reap any benefit except through this principle, although it is now contended by appellees that they claim solely on the theory of assignment. In one of the cases cited by appellees in support of the right of the court of bankruptcy to enforce an assignment, is the case of *In re Breakwater Company,* 232 Fed. at page 375. (Appellees' Brief, p. 23.) Here it was said:

> "A claim known as that of the Delaware Commissary Company, or the Joseph De Luca claim, against the bankrupt estate, was duly made and

allowed. The allowance was in part of a preferred claim. The petitioner was in fact a creditor, *not of the bankrupt, but of the claimant.* The only right he can possibly assert is that of an owner of part of the proven claim. Assignees of claims have the right, under the provisions of the bankruptcy law, to prove them against the estate just as other claims may be proven. The same limitation of time in which to make the proofs applies. This claimant delayed availing himself of the right thus given until the statute closed upon it. The right, in consequence, no longer exists. This is what the referee ruled and in this there was no error.

It is manifest that there was no need for such proof of claim, even if it had not been barred by the statute. The claim as against the estate had already been proven and allowed. There would have been neither need nor propriety in proving the claim over again. The petitioner, if he belongs anywhere, is clearly not in the proofs of claims class, but in the order class. The controversy, if there be any, is just as clearly not between the petitioner and the estate, but between the petitioner and the claimant. *Neither the estate nor the other creditors are concerned in the dispute.* General Order No. 21, section 3 (89 Fed. ix, 32 C. C. A. xxii), has application to assignees of proven claims. Section 57n applies only to claims against the estate. *The petitioner, if he can succeed in proving that he holds an assignment of the De Luca claim, may be subrogated as such assignee to the rights of the original claimant.* So far as the record discloses, this he has not asked to have done. We do not feel at liberty at this time to pass upon the right of the petitioner to subrogation. If he deems himself entitled to such right, it cannot in any orderly or satisfactory way be determined until he claims it. It may then be passed upon by the referee."

In this connection as to whether or not the trust deed is valid operates as an assignment, let us in turn quote the same portion from the trust deed that is quoted by the appellees, being paragraph 10 thereof:

> "The trustee shall advance such sums of money as it shall deem necessary to meet the present payroll of the lumber company and the mill company and to discharge the claims of the creditors who do not execute this instrument as it may deem necessary or requisite to protect the trust estate, not to exceed, however, the sum of $100,000, and the trustee shall have a *first and preference claim* upon said trust estate for the amount of such advancement, and the same shall be repaid to it out of the first proceeds of sale of the trust property or any part thereof or the first proceeds of any of the collected accounts or bills receivable, together with interest thereon from the date of such advancement at the rate of 6% per annum."

Supposing for the sake of argument that the trust deed is valid in every other respect, would this provision (and it is the only provision which creates either an assignment or a lien), create an assignment which in the first instance would authorize a court to either subrogate the appellees to the rights of the appellants or authorize a court to deliver funds due the appellants to the appellees without first a reformation of the contract or a judicial construction as to the intent of the parties? We think it is self apparent it would not, yet counsel states that the principle of subrogation is not involved and that he has not taken the pains nor gone to the trouble of reading our citations under this head.

If a court of bankruptcy is a court of general jurisdiction, if mortgages can be foreclosed as between third parties in which the creditors of an estate have no interest, if the ills, woes and troubles of mankind can be adjusted and settled therein, if contracts in which the general estate has no interest can be construed, if Congress did not know what it was doing when it conferred a limited jurisdiction on a court of bankruptcy, then the law cited with reference to construction of contracts, elementary law that we first learned when we studied the law of contracts and when the paths of lawyers seems strewn with roses and complexities could not arise, let us then admit for the sake of argument that the United States Supreme Court in the two cases cited by counsel spoke truly when it said that equity would favor such construction of a contract as equity could favor; but this court is not concerned in the construction of any contract in which the general creditors of this estate are not concerned.

Neither have we any fault to find with the law laid down in *Lecombe v. Steels,* 20 Howard 94, wherein the court says that in determining the construction of a contract, courts of equity make a distinction between matters of substance and matters of form. Herein the court refers to the land contract between A and B where a title should be cleared by the 25th of the month and was not cleared until the 26th and held that this was a substantial compliance with the contract; but what would the court have held in that case if C, a

stranger to the contract, an interloper, would have attempted to hold A to a contract made with B; would it hold that this was a "mere matter of form"?

Counsel state that it is patent "without the testimony that the parties understood exactly what would be done. That is shown by the correspondence and by the conduct of the representative, Mr. Katz." (Appellees' Brief, p. 37.) In this connection, we desire to take exception to the argument that is advanced by the chief counsel for the appellees, whose personality creeps throughout the entire brief wherein he refers to Mr. Katz as "the friend of the appellants", "the adverse witness" and "their representative, Mr. Katz." The record shows that when Mr. Katz came to Spokane, he became the confidant of Mr. Coman; that he wrote no letters to any creditor except in the office of Mr. Coman and that most of them were dictated by Mr. Coman; that everything he did while in charge of the plant was under the direct personal supervision of Mr. Coman and these various expressions used in this manner are far from ethical or professional.

Counsel cites the case of *Randolph v. Scruggs,* 190 U. S. 533-47 L. ed. 1165, which is merely a reiteration of the principle that in cases of assignment for benefit of creditors, services rendered or moneys paid which enure to the benefit of the estate can be paid out of the general estate; nor does this principle proceed upon the theory that the assignment for the benefit of creditors is so phrased as to create

such a lien but rather upon the general law. What the Supreme Court said was as follows:

> "It does not follow, however, from the avoidance of the deed that the service of preparing it did not raise a valid debt. There is no sufficient reason why it should not when once it is decided that the service for which the debt is alleged was lawful when it was rendered. Re Lains, 16 Nat. Bankr. Reg. 168, 170, Red. Cas. No. 7989.
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> The more difficult question is how to deal with the services rendered to the voluntary assignee. *The claim for them must be worked out through the assignee, and cannot be put higher than his claim for allowances, supposing that they had been paid. We may assume that there is no question of form before us, and that whatever the appellants properly might have been paid by the assignee they may prove for now.* See Central R. & Bkg. Co. v. Pettus, 113 U. S. 116, 124, 125, 28 L. ed. 915, 918, 5 Sup. Ct. Rep. 387; Mason v. Pomeroy, 151 Mass. 164, 167; 7 L. R. A. 771, 24 N. E. 202. But it has been held that the assignee, even of a corporation, cannot be allowed anything for his services before the filing of the petition in bankruptcy. See e. g. Re Peter Paul Book Co. 104 Fed. 786. *So far as* this opinion rests on *constructive fraud,* we have indicated above *that it does* not command our assent. The case *would* be different if the assignee were party to an actual fraud. Hastings v. Spencer, 1 Curt. C. C. 504, 507, Fed. Cas. No. 6201; Smith v. Wise, 132 N. Y. 172, 178, 30 N. E. 229; Perry-Mason Shoe Co. v. Sykes, 72 Miss. 390, 401, 28 L. R. A. 277, 17 So. 171. But the assignee is acting lawfully in what he does before proceedings in bankruptcy are begun, and although it may be assumed that the avoidance of the assignment relates back to the date of the deed, still, so far as his services, or

services procured by him, tend to the preservation or benefit of the estate, the mere fiction of relation is not enough to forbid an allowance for them. See Lynch v. Bernal, 9 Wall. 315, 325, 326, 19 L. ed. 714, 716. This is the doctrine of the state courts with reference to the operation of insolvent laws upon voluntary asignments, and of the better-considered decisions under the bankruptcy laws. Platt v. Archer, 13 Bltachf. 351, Fed. Cas. No. 11,214; Havemeyer v. Loeb, 5 Abb. N. C. 338, 345; Mcdonald v. Moore, 15 Nat. Bankr. Reg. 26, Fed. Cas. No. 8763; Wald v. Wehl, 18 Blatchf. 495, 6 Fed. 163, 169; Hunker v. Bing, 9 Fed. 277; Re Kurth, 17 Nat. Bankr. Reg. 573, Fed. Cas. No. 7948; Re Scholtz, 106 Fed. 834; White v. Hill, 148 Mass. 396, 19 N. E. 407; Clark v. Sawyer, 151 Mass. 64, 23 N. E. 726; Wakeman v. Grover, 4 Paige, 23, 43, 11 Wend. 187, 25 Am. Dec. 624; Collumb v. Read, 24 N. Y. 505, 515; T. T. Haydock Carriage Co. v. Pier, 78 Wis. 579, 47 N. W. 945; Perry-Mason Shoe Co. v. Sykes, 72 Miss. 390, 28 L. R. A. 277, 17 So. 171. See Williams v. Gibbs, 20 How. 535, 15 L. ed. 1013; Internal Improvement Fund v. Greenough, 105 U. S. 527, 532, 26 L. ed. 1157, 1160; Thompson v. Phenix Ins. Co. 136 U. S. 287, 294, 295, 34 L. ed. 408, 412, 10 Sup. Ct. Rep. 1019; Woodruff v. New York L. E. & W. R. Co. 129 N. Y. 27, 29 N. E. 251. If beneficial services are allowed for they are to be regarded as deductions from the property which the assignee is required to surrender, and in that way they gain a preference. Platt v. Archer, 13 Blatchf. 351, Fed. Cas. No. 11,214; Re Scholtaz, 106 Fed. 834; White v. Hill, 148 Mass. 396, 19 N. E. 407; Clark v. Sawyer, 151 Mass. 74, 23 N. E. 726.

We are not prepared to go further than to allow compensation for services which were beneficial to the estate. Beyond that point we

must throw the risk of his conduct on the assignee, as he was chargeable with knowledge of what might happen.

It does not appear how far the services to the assignee were beneficial. Therefore the questions of the circuit court of appeals cannot be answered in full. But the principles as to which it desired instruction may be stated sufficiently for the disposition of the case upon a subsequent finding of facts. None of the claims is entitled to preference under the deed. The charge for the preparation of the assignment properly may be proved as an unpreferred debt of the bankrupt. The services to the voluntary assignee may be allowed so far as they benefited the estate, and, inasmuch as he would be allowed a lien on the property if he had paid the sum allowed, the appellants may stand in his shoes, and may be preferred to that extent. No ground appears for allowing the item of services in resisting an adjudication of bankruptcy. See Platt v. Archer, 13 Blatchf. 351, 354, Fed. Cas. No. 11,214; Perry-Mason Shoe Co. v. Sykes, 72 Miss. 390, 398, 28 L. R. A. 277, 17 So. 171; T. T. Haydock Carriage Co. v. Pier, 78 Wis. 579, 582, 47 N. W. 945; Clark v. Sawyer, 151 Mass. 64, 23 N. E. 726.

We answer the questions as follows: (1) No. (2) Not under the deed, but, so far as the assignee would be allowed for payment of the claim, the claim may be preferred in the right of the assignee. (3) Not on the facts appearing in the certificate. (4) The charge for the preparation of the deed may be proved as an unsecured claim."

Equally elementary is the Massachusetts case cited, *Mason v. Pomeroy*, 151 Mass. 164; 24 N. E. 202, but is nowise instructive in the present action.

In the case *In re Chase,* 124 Fed. 753, and *Hurley, trustee, v. Railroad Co.,* 213 U. S. 132, merely bear out the general law that an assignee who benefits an estate may have, under certain circumstances, a preference claim therefor.

Digressing for the moment, however, there is no doubt in our mind what each of these courts would have said had the claimant asked that the dividends due to a third party be subrogated to the payment of his claim rather than his preference claim being paid out of the general estate, as in the case at bar. These cases are in nowise analogous nor have we any fault to find with them. The case *Atchison etc. Railroad Co. v. Hurley,* 153 Fed. 503, was where the railroad company being adjacent to a coal mine had advanced money to the company to be paid out in coal and upon the bankruptcy of the operating company asked a preference claim against the estate. It is also distinctly a litigation between the original contracting parties. The facts were in nowise analogous or even similar to the case at bar nor is this action from which counsel has quoted in any manner instructive here.

Neither have we any fault to find to the principle stated in *Ford v. Williams,* 21 How. 289, where it is stated that an undisclosed principal may sue but that principle does not apply to this class of cases in any event and especially does not apply where it appears that this agency acts as a fraud upon those who were to be bound by the agreement; it would not apply where an undisclosed principal

signs the agreement as a party to be bound thereby falsely representing that the concern is solvent; falsely represented that they owed it $6000 when in fact they owed it $21,000; prior to the time of claiming that it is a principal permitting its chief officer to testify that obligations in its hands, of the bankrupt, were null and void and that no credit had been extended thereon; that it was not treated as an indebtedness and long after the signing of the trust deed received from the insolvent creditor interest upon such indebtedness that it claims never existed, and retaining this same interest out of the very moneys that today they are asking be repaid to it. This matter, however, will be gone into more fully on the question of bad faith.

Much of the brief is occupied under this heading of the academic principle of the right of a holder of negotiable paper to sue whether or not he is the real party in interest. This is a principle generally founded on statute and in nowise concerns us in this action.

BAD FAITH.

In answering what counsel has to say on the question of the good or bad faith of the trustee and the bank, let us suggest to the court that in this and every action of kindred character where fraud is claimed, the full extent of the fraud is probably never discovered. In the following pages we will attempt to show piecemeal to the court,

the various accounts of fraud that we are in possession of. These accounts of frauds were wrung out of the mouth of one of the cleverest and most astute bankers in the northwest, by his own admission on cross-examination. We submit to the court, therefore, that this man who did attempt to hide from the appellants the true state of facts in this action, who was the close confidant and banker of the president of the bankrupt, the only interested party, the hand guiding the affairs of the bankrupt concern after the execution of the trust deed; who of necessity must have known of the precarious condition of the concern, at least after the time the trust was consumated and who kept silent and permitted money to be distributed and wasted, knew far more of the things that acted to the detriment of non-resident creditors than he was finally forced to admit while on the witness stand. The appellants contend and will always contend that Mr. Coman went to Minneapolis with the intention of deceiving these creditors; with the intention of assisting his client, Gibbs, and with the intention of gaining an advantage over every other creditor. Counsel would have this court believe that this bank and trust company acted in the best of faith with open conscience and clean hands as did the president of the bank attempt to make the appellants believe this fact until he was confronted with his own records when, although not a youth or an incompetent person, he sat dumb and voiceless when confronted with the fact that the records of his own

bank showed that he had perpetrated the fraud that the appellants claim was perpetrated. This has been gone into in the original brief but let us again briefly review it.

Mr. Katz testified that when he came to Coeur d'Alene to take charge of the Stack-Gibbs Lumber Company as the representative of the Mechanics Loan & Trust Company that the books of the bankrupt showed that the indebtedness to the local bank was $21,000 and not $6000 as the bank had represented. When Mr. Coman was cross-examined as to the existence of this difference of $15,000, he stated (Rec. 229):

> "In regard to the $15,000 note referred to by Mr. Katz in his testimony, dated December 31, 1915, and marked on the books here as cancelled or paid on February 14, 1916, Mr. Gibbs was negotiating a loan based on some collateral that was to come from a lumber concern in Denver. The collateral never came and the arrangement was never perfected. * * * I have here a copy of the Stack-Gibbs Lumber Company account from January 1st, 1916, and you will notice that during that month there was no credit of such an amount. * * * The item of $15,000 was never put to the credit of the Stack-Gibbs Lumber Company. The books of the bank and the lumber company would never agree so you could not produce anything."

Then again in (Rec. p. 230):

> "The $15,000 item is not on our books at all but I have some other books here that will show something about it. This only shows in a negative way that no such transaction took

> place between the Stack-Gibbs Lumber Company and the Exchange National Bank. This is a complete record of every loan made between the 31st day of December and the 15th day of February and which contains loans made to everybody else."

Under cross-examination, Mr. Adams stated that he would like to have the daily balance books of Februarly 5th and from the 15th of December up to the 15th of March—the Customers' Ledger. These were produced (Rec. p. 233):

> "Mr. Adams (reading from the books produced): Under December 30, state 233, under the column 'dates' is Stack-Gibbs Lumber Company, numbers 5 and 6, $5000, $10,000, 8-8, C. G. Gibbs. I would like to know when those notes were paid."

The witness apparently had no idea that this transaction had crept upon the books and at first refused to answer, finally blurting out, "we carry a separate account with Mr. Gibbs". (This entry appears in the bills receivable journal which was introduced in evidence.) (Rec. 234.)

It was immediately following this astounding testimony that the Exchange National Bank came into court and filed the unique petition that has been filed in this action, praying that the relief that was subsequently accorded or afforded be granted. (Rec. p. 235.)

If this were all, it might be explained but the record does not stop because after an adjournment had been taken and after Mr. Coman had had

ample time to think over what the effect of his testimony would be, after in all probability he had gone back to his bank and inspected his records and after counsel for appellants had found records of this transaction with pages pasted together as the record shows, he resumed the stand and again attempted to explain this $15,000 item. His explanation appears on page 236 of the record. He says:

> "Since my former testimony and upon returning to Spokane, I got hold of the records of the bank in respect to the two notes, one for $10,000 and one for $5000 * * * and these records I have shown to counsel. * * * There appears bills receivable, 27075, representing a loan for $5000 in the name of C. D. Gibbs, line 17 is 27076 and represents a loan of $10,000 to C. D. Gibbs. * * * On line 16 appears the endorsement, Stack-Gibbs Lumber Company. It also appears on page 261 under date, January 25, 1916, line 25, the following entry *representing a payment of notes, C. D. Gibbs, $5000, No. 27075,* * * * *and on the same date on page 262 appears the entry, loan paid $10,000,* C. D. Gibbs, No. 27076. This is on January 25, 1916, and is before I went to Minneapolis."

In this connection we will again show that this testimony was knowingly false because the notes were neither returned nor stamped paid until long after the meeting in Minneapolis and that interest was paid by the lumber company on these two notes and received and credited by the bank out of the very funds that it is claiming the trustee

advanced subsequent to the signing of the agreement but before we go into this, listen to the explanation of this astute banker as to why these notes appeared upon the records of a national bank.

> "The $10,000 note was used as a balance note and it was credited up in the books of the bank in Stack-Gibbs Lumber Company account No. 2 of which I have the duplicate sheets showing on December 30, 1915, a credit of $100,000 and on *January 25, 1916, a payment of $10,000 which also represents a closing entry on the books cancelling the other $10,000 note.*" (237.)

Now in connection with this testimony let us again refer back and quote:

> "That item of $15,000 was never put to the credit of the Stack-Gibbs Lumber Company." (Rec. 229.)

The record further shows that on February 12, 1916, a letter was written by the Stack-Gibbs Lumber Company to the Exchange National Bank as follows:

> "February 12, 1916.
>
> Exchange National Bank,
> Spokane, Washington.
>
> Gentlemen:
>
> We are herewith enclosing our check No. 2774 for $153.33 interest for forty days on the 14th on $10,000 and $5000 demand notes dated 12-30-15. If this meets with your approval kindly cancel the notes and return the same to us.
>
> Yours truly,
> STACK-GIBBS LUMBER CO."
>
> (238.)

The answer to the letter appears as follows:

"February 14, 1916.
Stack-Gibbs Lumber Company,
Gibbs, Idaho.
Gentlemen:

I acknowledge receipt of your letter of the 12th enclosing check for $153.33 interest on demand notes which are cancelled and returned herewith.

Yours very truly,
E. T. COMAN,
President." (238.)

As a final evidence of the duplicity of the bank, let us read then the explanation that is given by the president of the bank as to why they accepted interest upon an obligation that they claim never existed.

"I left for Minneapolis the last week in January *and just before I left, I charged off the $15,000.* I do not know why I did not send the notes right back. We charged the whole $15,000 off on the 24 and 25 of January and charged the company with interest up to the 12 of February." (246.)

(But why any interest should have ever been charged on this item if what Mr. Coman says is true is beyond comprehension.)

"I told Mr. Gibbs about it." (Rec. 246.)

It was at this point that Mr. Adams confronted the witness with these letters and a cancelled check of the Stack-Gibbs Lumber Company showing that the interest had actually been paid on this indebtedness long after the signing of the trust deed in Minneapolis. Then listen to the explana-

tion of the president of the bank of this transaction.

> "The check that you show me signed by the Stack-Gibbs Lumber Company by Mr. Gibbs together with the voucher is the check and voucher and my letter showing the payment of interest up to that date. *Apparently Mr. Gibbs did not object to paying interest after we charged it off and we made no objection to receiving it.*" (247.)

Again on record 251 under cross-examination:

> "Mr. Adams. I do not want any misunderstanding about any question that I ask. In this particular instance, the record shows the maker to be C. D. Gibbs.
>
> A. Yes, sir.
>
> Q. Gibbs endorsed Stack-Gibbs Lumber Company?
>
> A. Yes, sir.
>
> Q. Now to whom did the credit go, *the money itself?*
>
> A. Why, $5000 of it went on a certificate of deposit that was retained by the bank.
>
> Q. And the $10,000?
>
> A. *Why, the $10,000 went to the credit of this balance account which was called Stack-Gibbs account No. 2.*" (Rec. 251.)

In view of this resumé of the testimony, counsel for appellee boldly state that the conduct of the appellees is in accord with common honesty and fair dealing and that the present conduct of the appellants is not in accord with honesty and fairness.

Throughout the argument under this head, counsel refers to Katz as "Aaron's friend", a fact not borne out by the record and which is untrue and the reiteration throughout the argument that the

trust deed was drawn by Mr. Aaron which, while we are going out of the record in so stating, is denied by him. We do know, however, that some sort of a trust deed was drawn by Mr. Post at the instance of Mr. Coman and taken with them to Minneapolis, and for which Mr. Post was paid.

The argument directed to the question of whether or not there was an overdraft in the Coeur d'Alene bank and the bank in Spokane is equally unreasonable. If the writer has a balance in the bank of $1000 and gives a check to A of $2000, he has overdrawn his account so far as his knowledge is concerned and his records show. If A fails to present the check for payment, does not minimize the fact that the writer has overdrawn his account on his books. Whether eastern checks that were sent out by the Stack-Gibbs Lumber Company had on a certain day reached either of these banks would not change their books in any respect. These obligations in the form of checks were for immediate payment nor do we understand why counsel by showing by the bankers that the overdrawing checks had not yet arrived, should dispute the books of the bankrupt that there was an overdraft when if each of the checks had been presented in the usual course there would not have been sufficient money to have paid them. We do not deem an answer necessary to this lengthy discussion.

The explanation, however, of the two notes to which we have referred, the $10,000 and $5000

notes is unique to say the least. On January 25, 1916, Mr. Coman left Spokane for Minneapolis.

With reference to the portion of the brief that treats in explanation of the transaction that we have outlined at length over the issuance of credit on the $15,000 notes, counsel says in answer, that we "stirred up some dust" in relation to these notes and seem to content themselves with that very lucid explanation of this apparently absolute fraud. Mr. Coman admitted that practically all of the indebtedness of the Stack-Gibbs Lumber Company was made up by the officers of the company signing the obligation and the company endorsing the same, the credit going to the corporation bankrupt. Let us see then what explanation of this record statement of the transaction from the lips of Mr. Coman is advanced by the appellees in their answer brief.

> "On December 30, 1915, C. D. Gibbs, as maker, gave a note for $5000, which was also endorsed by Stack-Gibbs Lumber Company. A certificate of deposit for that amount was issued but retained by the bank because that note was to be secured by an acceptance on a lumber company in Denver. The security never came, and on January 25, 1916, before Mr. Coman started for Minneapolis, that certificate of deposit and that note were cancelled. The bankrupt never got any credit on any book of the bank for said $5000 and neither the bankrupt or Gibbs ever used the same." (Appellees' Brief, p. 67.)

> "As to the ten thousand-dollar note on December 30, 1915, such a note signed by C. D. Gibbs and signed or endorsed by Stack-Gibbs

> Lumber Company was made out. The amount of that note was credited in the Stack-Gibbs Lumber Company account No. 2 which was a balance account." (Appellees' Brief, p. 67.)

Counsel for appellee says that Mr. Coman told the creditors in Minneapolis about this transaction. This statement is absolutely untrue. Did the creditors know or have suspicion that a bank representing itself as a national institution would accept interest on a loan that was never made, from an insolvent creditor? Would the creditors for a second have considered entrusting their affairs to a financial institution that would stoop to work of this character? No wonder counsel content themselves with dropping this transaction with this meager explanation.

In the following argument which is supported by neither record nor fact is full of expressions such as "Mr. Katz got enthusiastic on behalf of his Chicago friends" and similar statements which we submit are out of place outside of the pettiest justice of the peace court. Mr. Katz is criticised because he testified to a charge upon the books of the company showing that on February 1st, the company owed the Exchange National Bank the $15,000 that Mr. Coman admitted existed as a charge. It will be remembered that Mr. Katz could not have made this entry; but on the other hand were he made a statement of the liabilities of the concern from even the bank's records this charge would have to have entered into the statement. Counsel state that we on cross-examination, did not go into

the question of overdraft with Mr. Coman but they advanced no reason why Mr. Coman did not explain it. Suffice to say that the court and the judges thereof remembering their experiences when trial lawyers, that if an adverse witness has been forced to admit things to his detriment that there is a limit to what his ingenuity can not overcome. Here was the president of a national bank speaking as an officer of that institution and it was his place when on the stand to have disclosed every record in relation to the transaction had by the bankrupt without it having to be drawn out from him piecemeal as we did draw out the revolting, disgusting action of the bank with reference to receiving interest on an obligation paid out of trust funds that was not owed.

Again counsel resents that part of the brief wherein we say that Mr. Gibbs and Mr. Coman had with them the trust deed that was prepared by Mr. Post when they went to Minneapolis. Why Mr. Post should be so sensitive on the question of the authorship of the trust deed we are unaware. Admittedly going outside of the record, we cannot refrain from calling attention to the fact that many believe Mr. Post is the author of the present trust deed. Counsel state that it is self-evident that after the execution of the trust deed the appellants or the Fort Dearborn National Bank sent an auditor to go over the books of the bankrupt. There is not a word or a suggestion in the record to bear out this statement.

NINETY PER CENT.

We have had but a few hours to prepare this reply brief before the time of the hearing and it must be rushed through to preparation and completion. The argument that ninety per cent of the creditors did in fact sign is so frivolous that we do not deem that an answer to it is necessary. They can not first build up a set of figures for one proposition and strike them down for another. The clear weight of the evidence is that ninety per cent did not sign, notwithstanding a frivolous technicality which counsel attempts to support by extracts from "Words and Phrases". But Judge Dietrich has expressly held that 90% never signed.

In re Creech Bros. Lumber Company, 240 Fed. 9, is not decisive of this action. That involved only the right of an assignee for the benefit of creditors to be reimbursed and this court simply restated the law of *Randolph v. Scruggs*, supra.

CONCLUSIONS.

But there are two further valid reasons why neither the bank nor the trust company can predicate any right upon the trust deed or any of its provisions. Counsel for appellees have seen fit in their brief to call particular attention to the incident in writing providing that the trust deed should not be recorded; and also have called particular attention to that portion of the decision of Judge

Dietrich referring to the non-recording of this instrument and to the further fact that everything was done possible to keep it a secret. Under these circumstances the trust deed is absolutely null and void, and neither the trust company nor the bank can predicate any rights of any kind upon it. That this is the law, regardless of any state statute, is clearly set forth in the case of *In re National Boat & Engine Company*, 216 Fed. 208. In this case the mortgage was drawn covering the property of the bankrupt, and by agreement of the parties it was expressly kept off the records. The court in passing upon this question used the following language on pages 212, 213, 214 and 215:

> "The first claim to be considered is that evidenced by $88,000 of the first mortgage bonds of the National Boat & Engine Company secured by the Astor Trust Mortgage.
>
> The bonds and coupons were filed with the proof and made a part of it. The consideration stated for the deposit and transfer of the $88,000, at par value, of bonds, is that the National Boat & Engine Company desired to have Butterfield surrender a certain trust deed, dated January eight, 1909, given by the Racine Boat Manufacturing Company to him, to indemnify him against indorsements upon notes amounting to over $41,000, assumed by the National Boat & Engine Company; that accordingly the National Boat & Engine Company entered into a certain agreement on April 6th with Butterfield to protect him on his indorsement, and deposited with the trustees named eighty-eight of the bonds, of the par value of $1000 each, as security for the fulfillment by the National Boat & Engine Company of its agreement with Butterfield. The surrender of

the trust deed is named in the proof of this claim as the consideration for the deposit of the bonds. Certain other considerations are now relied upon by the claimant; but no other consideration has been brought to the attention of the Court which seems sufficient to sustain the proof. The trustee in bankruptcy contends that the surrender of the trust deed of the Racine Company was no consideration whatever for the deposit of the bonds, because the trust deed was fraudulent in its inception, was voluntarily withheld from record by the consent, and with the connivance of Mr. Butterfield, and that it is void. Butterfield testifies that the vote of the company authorizing the deed was not transcribed, or inscribed in the original record book, and that it was left in loose sheets because it was hoped that the bond issue and preferred stock issue would wipe out the indebtedness, so that it would not be necessary to have any trust deed, and that in case the stock issue was enough to take care of the indebtedness, there would be no need of having any writing made in the books of the company relating to any trust deed.

With regard to the recording of the deed, the following testimony of Mr. Butterfield is before me:

'Q. Mr. Butterfield, was that mortgage deed covering all the real estate and properties and business of this Racine Boat Manufacturing Company ever recorded?

A. No, sir.

Q. Why not?

A. It was given with that understanding it was not to be recorded except any loss resulted —if I thought the company was on their last legs or about to fail—and then I was to use my own discretion whether to record it then or not.

Q. And why wasn't it recorded?

A. We thought by recording it, it would affect the credit of the company.

Q. In what way, how?

A. It would become publicly known, the conditions set forth in that trust deed, which would naturally affect the credit of the company.

Q. Publicly known to the creditors of the company?

A. Creditors and bondholders.

Q. And you say this was the understanding —the understanding with whom?

A. With Mr. Reynolds and the officers of the company, with myself and others interested, Mr. Reynolds, Mr. Ross and Mr. McCracken. * * *

Q. So pursuant to that understanding it was intentionally not recorded?

A. Yes. * * *

Q. And what was done in not recording was done with the knowledge of all the other directors of the Racine Boat Manufacturing Company?

A. Yes, sir.'

It appears, then, from Butterfield's testimony that the mortgage deed was intentionally kept from record; that this was done by agreement between him and certain other directors of the company; that it was done simply because, if publicly known to the creditors and bondholders, it would affect the credit of the company; that if it was found the company was 'on its last legs and was about to fail', he was then to use his own discretion whether to record the deed or not; that before any option had been obtained upon the properties of the Racine Boat Manufacturing Company, the plan of substituting bonds for the trust deed was talked over between himself and other directors; that it was agreed that no mention should be made in the trust deed of the option; that the trust deed was to be exchanged for bonds to

be held in escrow to cover the contingent liability for indorsements upon notes of the company; that he allowed the negotiations to go on with that understanding; that the prospectus issued by the promoters of the consolidation of the Racine and other companies with the National Boat & Engine Company contained no reference to the Racine Company trust deed. It appears, also, that neither the deed nor bill of sale by which the property of the Racine Company was transferred to the National Boat & Engine Company contained any reference to the trust deed, and that the deed of the real estate from the Racine to the National was a warranty deed of the property free from all incumbrances.

It is the doctrine of the Supreme Court that where, by collusion of the mortgagor, the mortgagee holds a mortgage from record for the purpose of giving the mortgagor a fictitious credit, and including others to give him credit, and the mortgagor fails and is unable to pay the debts thus contracted, the mortgage is fraudulent at common law. Blennerhasset v. Sherman, 105 U. S. 100, 26 L. Ed. 1080. Such a mortgage is held void at common law, whether the motive of the mortgagee be gain to himself, or advantage to the mortgagor. It is held that such a mortgage will not be made valid by the fact that it is supported by a sufficient consideration, and that a deed, not at first fraudulent, may afterwards become so by being concealed, or by not being produced, if thereby the creditors are induced to loan money. Hungerford v. Earl, 2 Vern. 261; Clayton v. Exchange Bank, 121 Fed. 630, 634, 57 C. C. A. 656; Davis v. Schwartz, 155 U. S. 631, 15 Sup. Ct. 237, 39 L. Ed. 289; Blennerhasset v. Sherman, supra, 105 U. S. 100, 26 L. Ed. 1080. In Sawyer v. Turpin, 91 U. S. 114, 23 L. Ed. 235, the Supreme Court held that the evidence did not

justify the assertion that there was any agreement that the bill of sale should not be recorded, or that possession should not be taken under it. Whenever such agreement is shown, the Supreme Court has held it sufficient to render a deed void at common law. In the Perkins case (D. C.), 155 Fed. 237, this court held from the facts disclosed that the non-recording of a 'conditional sales contract' was not a mere matter of omission, but was in pursuance of a distinct plan that there should be no record; and the court held the sale invalid. In the Shaw Case (D. C.), 146 Fed. 273, this court held a mortgage void for the reason that it was fraudulently withheld from record; there being a distinct and affirmative understanding that the mortgage was not to be recorded. Certain statutes and decisions of Michigan are cited by claimants, and it is true that local laws are controlling in many transactions in bankruptcy. Taney v. Penn. Bank, 232 U. S. 174, 180, 34 Sup. Ct. 288, 58 L. Ed. 558; Humphrey v. Tatman, 198 U. S. 91, 25 Sup. St. 567, 49 L. Ed. 956. But no Michigan law is brought to my attention in this case which overrides or varies the plain provisions of the Bankruptcy Law.

In Fourth Nat. Bank v. Willingham, 213 Fed. 219, just decided by the Circuit Court of Appeals of the Fifth Circuit, the court sustained the contention of the trustee in bankruptcy that a certain mortgage was 'withheld from record to bolster the credit of the mortgagor', and held that the mortgage was fraudulent and void because of the agreement between the parties that it should be withheld from record for such purpose. The court affirmed the decision of the court below on the authority of Clayton v. Exchange Bank, 121 Fed. 630, 57 C. C. A. 656, and of the Duggan Case, 183 Fed. 405, 106 C. C. A. 51 In both the cases last cited, the agreements to withhold the mortgage from record was only a tacit agreement.

In the case at bar, this agreement was distinct, open and unquestioned. It is brought before the court by the testimony of the claimant. The case shows an intentional non-recording of the trust deed for the distinct purpose of avoiding publicity, and to avoid injury to the credit of the company. The deed of the Racine Company to the National Company contained a warranty against all incumbrances, and made no mention of the existence of the Racine mortgage. The whole testimony shows a secret scheme and conspiracy to substitute bonds for the trust deed; that the conspiracy was entered into between the claimant, Butterfield, and certain other directors, with the evident purpose of concealing its existence from other members of the board of directors of the National Boat & Engine Company. I am forced to the conclusion that the trust deed of the Racine Company was fraudulent and void, and forms no basis for a valid transfer of the $80,000 par value of the bonds. The learned counsel for claimant contends that, outside the surrender of the trust deed, there was other consideration for the deposit of the $88,000 of bonds. He urges that there was an agreement by the claimant to renew his indorsements, and that there were other considerations. I find that under the circumstances of the case there was no other good and sufficient consideration for the transfer of the bonds, which would make such transfer valid as against the trustee in bankruptcy. And I further find that the transfer of the $88,000 of bonds was invalid as against said trust deed, for the reason that the same was a preference voidable by the trustee, both under the general principles of equity and the express provisions of section 60b of the Bankruptcy Act, as amended."

Under this authority the trust deed is an absolute nullity; and neither the trust company nor the bank

can use it for the purpose of enforcing any rights or remedies whatsoever.

The mere fact that not only the Exchange National Bank of Spokane but the appellants were parties to this agreement cannot assist the bank and trust company in the premises, because where an instrument of this character is void the court will leave the parties exactly where they place themselves. Even though the party raising the question may be in the wrong, still the court will not assist any of the parties to predicate any claim upon such a void instrument. But *when the situation exists as disclosed by the evidence, namely, that Coman the leading officer of both the bank and the trust company misrepresented the entire situation to the other creditors, and thereby induced them to enter into this contract, the other creditors, including the appellant, have a perfect right to insist upon the rule being enforced, namely, that this instrument is absolutely null and void.*

There is also the further answer to this proposition, namely, that this instrument does not constitute an equitable assignment as contended for by counsel for the appellee.

A case where the equities were exceedingly strong in favor of the party claiming the equitable assignment, was decided by Mr. Justice Swayne in the case of *Christmas v. Russell's Executors*, 20 Law Ed. p. 762. In this case a surety attempted to be subrogated. Every rule of equity and justice should have favored such an assignment where the surety is

called upon to pay the debt of its principal. There is also an express promise in this case that the surety should be paid out of this particular fund or property. The court in passing upon the question used the following language:

> "The evidence relied upon to suport the alleged lien, consists, so far as it is necessary to consider it, of letters from Richard Christmas to Yerger, written before Richard transferred to H. H. Christmas the notes originally given to Richard by Lyons. In a letter of the 25th of October, 1865, Richard said: 'I feel great uneasiness about your ability on the bond in suit of Russell against me. I have ever held the Lyons note as sacred for the payment of this debt, and have it now in New York, endeavoring to sell it with the mortgage, to pay this debt; I expect to hear from it daily. If not sold I will send it to you as soon as I return.' On the 14th of February, 1866, he wrote: 'I could not safely send you the Lyons note by mail as it is payable to me or bearer—hence if lost it might put me to much trouble'. On the 21st of the same month he said: 'You may rest assured I will protect you with the Lyons note.' In the next letter, of the 12th of May following, he announces the transfer of the notes to H. H. Christmas and said: 'In this I hope I have not lost sight of my purpose to protect you.' These letters contain no words of transfer, and nothing which by construction or otherwise can have any effect in that way. At most they are only evidence of a promise to pay the judgment, if affirmed, out of the proceeds of one of the notes, and to send the note, if not sold, to Yerger.
>
> An agreement to pay out of a particular fund, however clear in its terms, is not an equitable assignment; a covenant in the most solemn form has no greater effect. The phraseology employed is not material provided the intent to

> transfer is manifested. Such an intent and its execution are indispensable. The assignor must not retain any control over the fund—any authority to collect, or any power of revocation. If he do, it is fatal, to the claim of the assignee. The transfer must be of such a character that the fund-holder can safely pay, and is compellable to do so, though forbidden by the assignor. Where the transfer is of the character described, the fund-holder is bound from the time of notice. Rogers v. Hosack, 18 Wend. 334; Hoyt v. Story, 3 Barb. 263; Dickenson v. Phillips, 1 Barb. 461; Clayton v. Fawcet, 2 Leigh 19; Hopkins v. Beebe, 26 Pa. St. 85; Hall v. Jackson, 20 Pick. 194. A bill of exchange or check is not an equitable assignment *pro tanto* of the fund of the drawer in the hands of the drawee. Cowperthwaite v. Sheffield, 3 N. Y. 243."

Counsel for appellee asked what interest would the Exchange Bank have in advancing the $100,000. When the facts are brought to the attention of the court the answer is self-evident. The Exchange National Bank of Spokane prior to January 1st, 1916, held a $100,000 mortgage on the plant of the mill company. This mortgage is signed by both the mill and the lumber company. There has never been any question but what the security was wholly inadequate. Prior to the Minneapolis meeting the record shows that Mr. Gibbs had a conversation with Mr. Coman in respect to the financial condition of his company, and Coman sent a representative up to Coeur d' Alene to make an examination of the affairs of the company. On January 5th the Exchange National Bank had the mill company pay it $10,000 on account of its principal and interest

on this mortgage, leaving approximately $92,500 still due. In addition there is the $21,000 due the Exchange Bank about which there can be no dispute. Mr. Coman first denied that any such item existed, and then when confronted with the evidence was forced to admit that it did exist but claimed that it had all been settled up. Then when confronted with this letter admitted that he had collected the interest, and then finally at the close of the hearing the original notes themselves were finally discovered and *showed the original bank stamp paid the day before Katz arrived at Spokane.* But this is not all. It appears that Mr. Post prepared a deed of trust, whether *in form as that one,* signed or not, it does not appear, but it does appear that he corrected it upon the day of its return to Spokane so as to suit his desires, and that he prepared all of the minutes and the records for the corporation to pass and attended the meeting and appeared to have represented the lumber company and the mill company, and the bank in all of the transactions. In the deed of trust which was signed not only was the bank to retain its lien upon the property under the original mortgage, which it held, $92,500, but it should also participate, with all of the other creditors upon any funds or moneys derived from the proposition, thereby giving to the bank the same right as a general creditor that everyone else had, and in addition retaining its security.

Counsel for appellee lay considerable stress upon a letter written by Coman to Mr. Aaron on the

ninth day of February, 1916, and say that Mr. Aaron did not make any protest against the paying out of this money, and therefore the question of its payment was waived. It is interesting to see exactly what occurred. The trust deed provides: (a) that this agreement shall not become effective until 90% of all of the creditors have signed; (b) that it shall not become effective until it has been properly ratified and executed by the lumber company and the mill company, and the extension of the mortgage held by the Exchange Bank shall have been made; (c) that it shall not become effective until Katz shall have been elected treasurer, secretary, and director of the company. Admitting that everything that Mr. Post has stated with respect to Mr. Katz is correct, that he represented the eastern parties, the fact that the contract provided that he should be elected treasurer, and that the contract should not become effective until he was elected treasurer, the provision must have been for some purpose, namely, that no money should be paid out until Katz should be on the job. Now, what occurs? On February 9th, 1916, Mr. Coman writes (he does not wire) to Mr. Aaron, and says that they need some money for the current payroll. This letter could not possibly reach Chicago before the 12th day of February by the fastest mail. On the 15th Mr. Aaron replies to the letter and says that Mr. Katz left on the 13th for Spokane. *Does Mr. Coman wait for any reply from Mr. Aaron? Not at all.* On February 9th he discounts for it

eight notes amounting to $40,000, and the money is not all used for payroll purposes. Part of it went to the Dryad Lumber Company; and the records show that over three thousand of it was used to pay interest. Part of it was used to retain a balance in the Exchange National Bank. Part of it was used to pay a man named Thornton, a logging contractor. $7000 was used to pay the Milwaukee Railroad freight claim. Two principal items which are very interesting, namely, $3700 was used to pay the Bardwell-Robinson Company, and $9500 to pay the Lambert Lumber Company for cash which these two concerns had advanced the lumber company. The excuse being that they were friends of Gibbs, and that he wanted to see them get their money back. $12,000 was used to pay bank overdrafts. (Record page 151.) And the only bank that had any overdraft was the Exchange National Bank of Spokane and the Exchange Bank of Coeur d'Alene.

And if we believe what counsel for appellee say that there was no overdraft at Coeur d'Alene, then the overdraft must have all been at the Exchange Bank of Spokane. There was no overdraft at the Fort Dearborn National Bank, because there was no checking account being carried there. But this is not all. On the 16th day of February, $20,000 more is discounted, and paid out in a similar manner.

There is another interesting topic raised by counsel Post. Counsel Post contends that the business was carried on in pursuance of the deed of trust

and that everyone knew that it was so being conducted. There are several answers to this proposition, and we will make them as short as possible.

(a) Katz was never allowed to write a letter back to Chicago, or to any of the other creditors without having it first censored by Mr. Coman; and they were in a majority of instances written in Mr. Coman's office.

(b) That the court will recall that the trust deed was not executed by the mill or lumber company until the 18th day of February, 1916, and was not accepted by the trust company and executed by it until about the 29th day of February, 1916.,

There is no pretense that any possession was taken, nor could there have been any possession taken until the contract was duly executed.

The followed moneys were advanced by the Exchange National Bank prior to the agreement being executed and prior to Katz having anything to do with the proposition, namely, February 9th, $40,000; February 16th, $20,000; and prior to the execution of the agreement by the trust company there was $5000 on February 24th and $5000 on February 26th, making a total of $70,000. So that there has been $70,000 loaned the company prior to any contract of any kind being consummated. But this is not all. B, article IV of this contract provides as follows:

> "The trust company *shall* collect such debts owing to the lumber company and the mill company as are collectible", etc.

The court will see that this provision of the contract is not contingent upon the whim or desire of the trust company, but is an absolute obligation to do something. *The trust company never collected any debts of any kind.* Article X which is relied upon by counsel we perceive, is as follows:

> "The trust deed shall advance such sums of money as it shall deem necessary to meet the present payroll of the lumber company and the mill company and to discharge the claims of the creditors who do not execute this agreement as it may be necessary or requisite to protect the trust estate, not to receive, however, the sum of $100,000; and the trustee shall have a first and prior claim upon said trust estate for the amount of such advancement."

Article X only authorizes the trust company to advance money for two specific purposes, namely, to meet the payroll and to discharge the claim of creditors who do not execute this instrument. It was therefore incumbent upon the trust company and the bank to show what funds they advanced for the purpose as outlined by this portion of the contract. They did not have and they could not have any claim for preference of any funds used for any other purpose than for payroll and for the claims of creditors who did not execute this instrument. It must be apparent to anyone who reads this record that the record wholly fails to point out exactly what all of this fund was advanced for. It does appear that a large portion of it was not advanced for the purpose of meeting the payroll and the demands of creditors who had not signed the agreement. It

must further be apparent that if Mr. Coman was so fitfully ignorant as counsel would pretend he was, that it did not occur to him that when it was necessary to pay out $70,000 before Mr. Katz could arrive upon the scene, there must have been something radically wrong with the affairs of this lumber company. 10% of the signing creditors is $63,900; now when you have to pay out $70,000 before the document is executed by the lumber company even Coman should have become alarmed. But the answer to the proposition is very clear, namely, out of the advancement made, Coman had already repaid himself. He could work down his mortgage so that the security could pay out the balance due. If he could run this property long enough to get himself in the clear, it did not make much difference to him what happened to the other creditors. There was no objection on Coman's part to allowing them to sleep peacefully on, ignorant of the true situation; *and it cannot be denied that these creditors, who are thousands of miles away, must have been relying upon Mr. Coman and his representations.*

Another reason advanced by counsel for the paying out of this $70,000, is that Mr. Coman had orally arranged with Mr. Gibbs that money might be paid out before the contract was signed. Counsel must indeed be in sore straights if he is relying upon the alleged oral agreement between Gibbs and Coman made in Minneapolis, whereby Coman pays out the money and thus jeopardizes the rights of the creditors of the estate. And regardless of whether such

an arrangement could or could not be made, suffices to say that under the terms of the contract no such arrangement would be good because the contract did not become operative until ninety per cent of the creditors had signed and Katz had become treasurer. Even Mr. Post was forced to admit that this so-called arrangement with Mr. Gibbs is of no force or effect. (Page 223 of the Record.)

> "Mr. Post. Now, Mr. Coman, I see in this letter you state that it will be necessary to make some advances in anticipation of the arrival of the contract; tell the court whether or not Mr. Gibbs in Minneapolis orally concurred and agreed to that contract?
>
> Mr. Adams. I object to that.
>
> The Referee. On what ground?
>
> Mr. Adams. Mr. Gibbs couldn't orally agree to a contract of this character, could he?
>
> Mr. Post. He couldn't bind a corporation to do it of course. (198)
>
> Mr. Adams. It is up to the contract to be executed in due form as the contract provides.
>
> Mr. Post. I do not contend it binds the corporation but it shows the attitude not only of Mr. Coman but also of Mr. Aaron and the other gentlemen who were in relation to it.
>
> The Referee. The objection overruled, the answer may be taken for what it appears to be legally worth.
>
> A. Yes, that is what he went down there for."

Mr. Post was thoroughly familiar with the terms of this contract because he prepared an amendment to it, and he must have known that the contract could not have become operative until the conditions precedent named in the contract had

been complied with. Mr. Post takes exception to our statement that Gibbs with Coman submitted a statement of the assets and liabilities, which was false, at the Minneapolis meeting. According to the testimony of Mr. Coman, Mr. Gibbs submitted to the creditors at Minneapolis a statement of the assets and liabilities. On that statement, according to Coman's testimony, the Exchange Bank figured on the basis of $6,000. At least to the amount due to the Exchange Bank he knew that statement was false, but Coman continues to misrepresent the situation. J. K. Stack, one of the largest creditors, holding a claim of $100,000, was not at the meeting or represented; but Coman writes back as follows:

> "This arrangement has been the result of a conference of the different creditors of Mr. Gibb's concern, representing more than ninety per cent of the indebtedness."

This is an absolutely false statement. J. K. Stack, Mrs. Tolerton and Mrs. Gibbs were not represented at the meeting, and their total claims amounted to $143,000. There was not ninety per cent of the creditors at the meeting, and it required more than the signature of Mrs. Tolerton at the meeting to make the ninety per cent. It required the signature of Stack, Tolerton and Gibbs and in the neighborhood of $50,000 more to make ninety per cent of the creditors, which $50,000 never was secured.

There can be no doubt but that from a reading of this evidence that the whole scheme was to trustee this property to the Mechanics Bank, so as

to work out the plan agreed to between Coman and Gibbs in Spokane long before the Minneapolis meeting of creditors was ever called by Coman.

The record also shows that when Mr. Katz arrived in Spokane he immediately reported to Mr. Coman. (Record page 195.)

> "Mr. Coman told me that Mr. Gibbs was a very able man, that he was especially a great lumber salesman and I should try to get along with him tactfully. The whole tone of the conversation and subsequent conversations was to get the confidence of the people and get their friendship."

And the further record (page 200):

> "Mr. Coman did not tell me anything about taking possession and notifying the people that I was in possession. I was told to take good care that nobody else would find out about it, this trustee agreement was to be kept absolutely strictly secret before anybody else; I remember at one time the representative of Dun's or Bradstreet's found it out and one time when I was in Spokane called me up at the Exchange Bank and told me to come over and had a talk with me and I was suspicious of that talk and asked Mr. Coman about it, what I should tell him, and Mr. Coman gave me the advice to say that we do not expect to ask for additional credit and to refuse all information, which I did (154). We had several conversations, that is, Mr. Coman and I, of this character. I couldn't remember all, but we had a few conversations about that topic."

The first information that the appellant or anyone outside of Coman and his bank and Gibbs ever knew about the $15,000 loan, was when the hearing

of this case was being had before Referee Lewis. Even the witness Katz knew nothing about it until that time.

At this time the petition of the Exchange Bank had not been filed. Katz asked what the $60,000 had been paid out for and was shown the letter which had been written setting forth the figures which appear on page 151 of the record. When we came to examine the books we found it in the account of the Exchange National Bank, and discovered that their account instead of being $6,000 it was $21,000; and the following occurred before the Referee, record, page 195:

> "Q. You find an item on the 15th of $15,000 credited to the Exchange National Bank; when was your attention first drawn to that item?
>
> A. Practically this morning when I looked through the books; I saw at a glance when I talked to you on Saturday——
>
> Q. Who do you refer to by you?
>
> A. Mr. Post, and we talked about that something must be wrong and I looked over it and that item of $15,000; when I read those figures out of the books I wasn't asked about it and I didn't mention it.
>
> Q. Was that a part of your first $40,000 paid out of those notes that we discounted?
>
> A. It must have been."

Mr. Post and Mr. Coman immediately denied that any such thing ever existed. We have abundantly

pointed out where Mr. Coman falsified and stultified himself in this respect.

Respectfully submitted,

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